Next Steps on Tax Reform

Chairman Max Baucus and Ranking Member Orrin Hatch
U.S. Senate Committee on Finance

June 27, 2013

Dear Colleague,

We write today to ask you for your input as the Finance Committee moves forward with comprehensive tax reform.

America's tax code is broken. The last major reform of the tax code was the Tax Reform Act of 1986, which is considered by many as the gold standard for tax reform. However, since then, the economy has changed dramatically and Congress has made more than 15,000 changes to the tax code. The result is a tax base riddled with exclusions, deductions and credits. In addition, each year, it costs individuals and businesses more than $160 billion to comply with the tax code. The complexity, inefficiency and unfairness of the tax code are acting as a brake on our economy. We cannot afford to be complacent.

Over the past three years, the Finance Committee has been working on tax reform on a bipartisan basis. We have held more than 30 hearings and have heard from hundreds of experts on reforming the code—how to make it simpler for families and businesses and spark a more prosperous and competitive economy. In addition, over the past three months, we have issued ten bipartisan options papers totaling more than 160 pages that detail reform proposals we are considering in every area of the tax code. The full Committee has met on a weekly basis to discuss these options papers and how to put plans into action. We are now entering the home stretch.

Colleagues, now it is your turn. We need your ideas and partnership to get tax reform over the finish line. In order to make sure that we end up with a simpler, more efficient and fairer tax code, we believe it is important to start with a "blank slate"—that is, a tax code without all of the special provisions in the form of exclusions, deductions and credits and other preferences that some refer to as "tax expenditures."[1] This blank slate is not, of course, the end product, nor the end of the discussion. Some of the special provisions serve important

[1] A complete list of these special tax provisions as defined by the non-partisan Joint Committee on Taxation can be found at https://www.jct.gov/publications.html?func=select&id=5.

objectives. Indeed, we both believe that some existing tax expenditures should be preserved in some form. But the tax code is also littered with preferences for special interests. To make sure that we clear out all the unproductive provisions and simplify in tax reform, we plan to operate from an assumption that all special provisions are out unless there is clear evidence that they: (1) help grow the economy, (2) make the tax code fairer, or (3) effectively promote other important policy objectives.

Today, we write to ask you to formally submit legislative language or detailed proposals for what tax expenditures meet these tests and should be included in a reformed tax code, as well as other provisions that should be added, repealed or reformed as part of tax reform. In order to give your proposals full consideration as we work to craft a bill, we request these submissions by July 26, 2013. We will give special attention to proposals that are bipartisan.

To help inform your submissions, we asked the nonpartisan Joint Committee on Taxation and Finance Committee tax staff to estimate the relationship between tax expenditures and the current tax rates if the current level of progressivity is maintained. While Members of the Senate have different views on whether the revenue raised from eliminating tax expenditure or other reforms should be used to lower tax rates, reduce the deficit, or some combination of the two, we believe that everyone should understand the trade-offs involved when adding tax expenditures back to the tax code.

The blank slate approach would allow significant deficit reduction or rate reduction, while maintaining the current level of progressivity. The amount of rate reduction would of course depend on how much revenue was reserved for deficit reduction, if any, and from which income groups. However, as shown in the chart below, every $2 trillion of individual tax expenditures that are added back to the blank slate would, on average, raise each of the seven individual income tax brackets by between 1.3 and 2.2 percentage points from what they would be under the blank slate. Likewise, every $200 billion of corporate tax expenditures that are added back to the blank slate would, on average, raise the top corporate income tax rate by 1.5 percentage points from what they would be under the blank slate. These estimates demonstrate that the more tax expenditures we allow in the tax code, the less we will be able to reduce tax rates or reduce the deficit. As we work to craft a tax reform bill, we will bear these trade-offs in mind.

While we believe that taking a hard look at every income tax expenditure is an essential part of tax reform, we also encourage you to examine other aspects of the tax code. For example, many provisions of the income tax that are not considered tax expenditures could be greatly simplified. In addition, almost half of federal tax revenues come from sources other than

income taxes. The tax reform process will therefore involve much more than just income tax expenditures.

Our tax code is bloated and outdated. The income tax was established a century ago, in 1913. And it has been a generation since our last tax reform in 1986. As Chairman and Ranking Member of the Finance Committee, we are determined to complete tax reform this Congress. We look forward to your ideas and to working together to accomplish this historic goal.

Average Effect on Tax Brackets of Adding Back Tax Expenditures, Maintaining the Current Level of Progressivity[2]

Income Range for Current Tax Brackets	Average Effect on Tax Rate of Adding Back $2T in Individual and $200B in Corporate Tax Expenditures over 10 Years
Individual	
Under $18,000	1.3 percentage points
$18,000-73,000	1.5 percentage points
$73,000-146,000	1.9 percentage points
$146,000-223,000	2.2 percentage points
$223,000-398,000	1.3 percentage points
$398,000-450,000	1.4 percentage points
Over $450,000	1.5 percentage points
Corporate	
All	1.5 percentage points

[2] These estimates represent an average effect because the effect on tax rates of adding back, for example, $1 trillion in individual tax expenditures is not as large as the effect of adding back a second $1 trillion in tax expenditures. Put differently, it becomes increasingly costly to lower the tax rates as the tax rates go down through base broadening. The current level of progressivity means the level of progressivity in 2017. Certain tax expenditures are excluded from the analysis where doing so is necessary to maintain the current level of progressivity. The income ranges for the current tax brackets are for married taxpayers filing jointly.